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Central Intelligence Agency

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DIRECTORATE OF INTELLIGENCE

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Yugoslavia: Obstacles to Economic Reform

Summary

Yugoslavia has formally committed itself to a program of economic reform to address economic problems that have grown since Tito's death. While this program has some supporters at home and abroad, numerous obstacles to reform exist in the unorthodox, highly decentralized communist system. We believe that these obstacles are strong enough to thwart significant nationwide reform for years to come, even under the present strong-willed government of Premier Branko Mikulic. Western pressure may encourage Belgrade to adopt further market-oriented laws but, as in the past, will have only limited impact on their implementation. Moreover, Yugoslav leaders would probably unite against most systemic obstacles only in the unlikely event of near economic collapse, and even then would probably turn to old-line central controls rather than Western-style market solutions. [redacted] 25X1

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The Stabilization Program

Economic problems have dominated Yugoslav attention since Tito's death in 1980 when the economic boom of the 1970s, based largely on foreign loans, came to an end. Pressured by financial crisis, Belgrade responded to the urgings of the IMF and Western creditors and approved in 1983 an ambitious economic stabilization program which emphasizes the role of market forces in the economy. The government has pledged to introduce laws assuring, inter alia, positive real interest rates, market determination of prices for most goods, an end to state subsidies for unprofitable firms, and linkage of wages to productivity.

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The government, however, has failed to make good on even the first phase of the program--stopping "negative trends" by 1985. Inflation and unemployment have remained among the highest in Europe, business losses have mounted, and economic growth and export performance have remained weak. A series of reschedulings--launched by the US-led "Friends of Yugoslavia" in 1983--and associated IMF standby programs have given Yugoslavia "breathing room" to deal with its debt problem. But despite some improvement in its financial position and relations with creditors, Belgrade is still unable to meet all obligations on its $19 billion debt and will require more debt relief for the foreseeable future.

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Systemic Obstacles

At the heart of the government's problems has been an array of systemic obstacles to formulating, passing, and implementing a coherent program of economic reform:

- Concern Over Public Reaction. As in other debtor countries, regime concern about public reactions to the painful short-term effects of economic adjustment -- such as jumps in unemployment, inflation, and business failures -- have deterred implementation of tough reform measures. Much of the public still seems to prefer quick administrative controls rather than real reform.

- Legislative Snags. Unlike parliaments in other communist countries, Yugoslavia's Federal Assembly is no rubber-stamp, and it has hamstrung some government initiatives for basic economic change. Moreover, the constitution requires unanimous consent by the eight regions on most important legislation, frequently diluting and delaying the government's draft laws.

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- Workers Power. Yugoslavia's unique "self-management" system gives workers control over many basic decisions in their enterprises, complicating the government's ability to regulate the economy. Workers, for example, have exploited the law to give themselves sizable wage increases regardless of enterprise performance, undercutting efforts to tie wages to productivity.

- Regional Autonomy. Regional leaders, who frequently differ with federal policy, often neutralize the government's economic program at the local level. Regional bodies -- and not a federal administration or a centrally-run Communist Party -- control implementation of most federal laws. They also have legislative authority over important matters such as tax policy.

- Uneven Economic Development. Federal legislation must cope with extremely diverse economic conditions -- ranging from prosperous, industrialized Slovenia to almost Third World backwardness in Macedonia and Kosovo. Officials in the developed north often say federal laws are at odds with local conditions, while southern officials probably are unsure how to apply market-oriented laws to their often rudimentary economic systems.

- Ideological Resistance. While communist ideology has played a decreasing role in Yugoslav policymaking, welfare state values remain widely accepted and undercut support for market-oriented measures.

- Market Fragmentation. Market-oriented legislation often is ineffective -- and at times counterproductive -- because of the extreme fragmentation of the markets. The goods market is often broken up at the republic or even county levels by protective local officials. Monopolistic producers exploit price liberalization measures to raise prices, contributing to inflation. The capital market is both fragmented and underdeveloped. Banks are controlled by local firms and officials, and lending is often based on political decisions. The labor market is also broken up along regional and even local boundaries.

- Ethnic Divisions. Centuries-old divisions and antagonisms among Yugoslavia's seven major ethnic groups exacerbate many of the above obstructions, particularly market fragmentation. Most Yugoslavs prefer to deal with their own group.

- Weak Work Traditions. Even with a more market-oriented system, many Yugoslavs -- particularly in southern areas long under Turkish rule -- would have to overcome centuries of tradition that discourage individual enterprise. [redacted] 25X1

Outlook

Belgrade appears genuinely committed to removing some of these systemic obstructions and is already planning some new moves. The Mikulic government, for example, has indicated it will seek changes in the constitution to increase its economic authority over the regions and in the labor law to improve work discipline. But these and other plans are already encountering strong resistance. The regions almost certainly will be able to block or dilute the constitutional changes necessary to strengthen federal authority and apparently will accept only "clarifications" to the labor law, not a significant cut in workers' rights. [redacted] 25X1

Yugoslav leaders for now will continue to rely mainly on administrative half-fixes, despite growing frustration among Western creditors. At best, Western pressure may encourage Belgrade to propose further market-oriented legislation, but such pressure will not ensure passage or implementation of the laws at the federal or regional levels. Headway in overcoming systemic problems probably will be measured in years, as part of the evolution away from the Soviet model that began when Tito broke with Stalin in 1948. Yugoslav leaders would probably unite to patch over their systemic problems only in the unlikely event of imminent economic collapse. But in that case they would likely fall back on old-line central controls rather than market-oriented reform. [redacted] 25X1

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